



## ***CRS Report for Congress***

# **Trade Preferences for Developing Countries and the WTO**

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### **Summary**

World Trade Organization (WTO) Members must grant immediate and unconditional most-favored-nation (MFN) treatment to the products of other Members with respect to tariffs and other trade-related measures. Programs such as the Generalized System of Preferences (GSP), under which developed countries grant preferential tariff rates to developing country products, are facially inconsistent with this obligation because they accord goods of some countries more favorable tariff treatment than that accorded to goods of other WTO Members. Because such programs have been viewed as trade-expanding, however, Contracting Parties to the General Agreement on Tariffs and Trade (GATT) provided a legal basis for one-way tariff preferences and certain other preferential arrangements in a 1979 decision known as the Enabling Clause. In 2004, the WTO Appellate Body ruled that the Clause allows developed countries to offer different treatment to developing countries in a GSP program, but only if identical treatment is available to all similarly situated GSP beneficiaries. Where WTO Members' preference programs have provided expanded benefits, Members, including the United States, have generally obtained WTO waivers. In December 2006, Congress extended the GSP program until December 31, 2008, and Andean preferences until June 30, 2007, allowing conditional extension of Andean benefits for six months thereafter (P.L. 109-432). The 2006 statute also extends a third-country fabric provision in the African Growth and Opportunity Act and expands textile benefits for Haiti. P.L. 110-42 has extended the Andean program to February 29, 2008, and removed the conditions enacted in 2006. S. 222 (Graham) would extend to one year the period for the President to determine if Haiti meets eligibility requirements for textile benefits contained in the 2006 enactment. S. 652 (Smith) would authorize the expansion of preferences for least-developed countries. H.R. 3427 (McDermott) would limit the President's authority to revoke waivers of the GSP competitive need limitation and thus remove GSP benefits. This report will be updated.

### **Trade Preferences and GATT MFN Requirements**

As parties to the General Agreement on Tariffs and Trade (GATT) 1994, World Trade Organization (WTO) Members must under Article I:1 of the GATT grant

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immediate and unconditional most-favored-nation (MFN) treatment to the products of other Members with respect to customs duties and import charges, internal taxes and regulations, and other trade-related matters. Thus, whenever a WTO Member accords a benefit to a product of one country, whether it is a WTO Member or not, the Member must accord the same treatment to the like product of all other WTO Members.<sup>1</sup> Tariff preference programs for developing countries are facially inconsistent with this obligation as the favorable treatment provided by the granting country to the goods of a specific group of countries is not extended to all WTO Members. Since preference programs have been viewed as vehicles of trade liberalization and economic development for developing countries, however, GATT Parties have accommodated them in a series of joint actions.

In 1965, the GATT Parties added Part IV to the General Agreement, an amendment that recognizes the special economic needs of developing countries and asserts the principle of nonreciprocity. Under this principle, developed countries forego the receipt of reciprocal benefits for their negotiated commitments to reduce or eliminate tariffs and restrictions on the trade of less developed contracting parties.<sup>2</sup> Because of the underlying MFN issue, GATT Parties in 1971 adopted a waiver of Article I for the Generalized System of Preferences (GSP), which allowed developed contracting parties to accord more favorable tariff treatment to the products of developing countries for 10 years.<sup>3</sup> The GSP was described in the decision as a “system of generalized, nonreciprocal and nondiscriminatory preferences beneficial to the developing countries.”

At the end of the GATT Tokyo Round in 1979, developing countries secured adoption of the Enabling Clause, a permanent deviation from MFN by joint decision of the GATT Contracting Parties. The Clause states that notwithstanding GATT Article I, “contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties” and applies this exception to: (1) preferential tariff treatment in accordance with the GSP; (2) multilateral nontariff preferences negotiated under GATT auspices; (3) multilateral arrangements among less developed countries; and (4) special treatment of the least-developed countries “in the context of any general or specific measures in favour of developing countries.”<sup>4</sup>

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<sup>1</sup> While the WTO uses the term “most-favored-nation” to describe nondiscriminatory trade treatment, U.S. law has since 1998 referred to this treatment as “normal trade relations” (NTR) status. *See* P.L. 105-206, § 5003. This report uses the WTO terminology.

<sup>2</sup> Edmond McGovern, *International Trade Regulation* ¶ 9.212 (updated 1999)[hereinafter McGovern]. Part IV is generally viewed as nonbinding, though some have argued otherwise with regard to certain of its provisions. *Id.*; John H. Jackson, William J. Davey & Alan O. Sykes, Jr., *Legal Problems of International Economic Relations* 1171 (4<sup>th</sup> ed. 2002).

<sup>3</sup> GATT, Generalized System of Preferences; Decision of 25 June 1971, L/3545 (June 28, 1971).

<sup>4</sup> GATT, Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries; Decision of 28 November 1979, L/4903 (Dec. 3, 1979). In 1999, the WTO General Council waived GATT Article I:1 until June 30, 2009, to allow developing country Members to provide preferential tariff treatment to products of least-developed countries, without being required to do so for like products of other Members. WTO, Preferential Tariff Treatment for Least-Developed Countries; Decision on Waiver, WT/L/304 (June 17, 1999).

To describe the GSP, the Clause refers to the above-quoted description in the 1971 waiver. The Enabling Clause has since been incorporated into the GATT 1994.<sup>5</sup>

## **WTO Waivers for Preferential Trade Agreements**

The European Union had argued in the GATT that it could further deviate from Article I:1 MFN requirements for nonreciprocal free trade with developing countries under GATT Part IV, discussed above, as well as Article XXIV, which provides an MFN exception for customs unions and free trade areas meeting specified conditions. At issue was the Lomé IV Convention, a preferential, nonreciprocal trade arrangement between the EEC and African, Caribbean and Pacific (ACP) countries. The Convention extended beneficial tariff and quota treatment to ACP imports as well as development assistance to ACP countries. GATT panels concluded in unadopted 1993 and 1994 panel reports that such a deviation was not justified under either provision.<sup>6</sup> Regarding the Article XXIV claim, the 1994 report concluded that because the Lomé Convention involved non-GATT Parties, the Article did not cover the agreement and thus could not be used to justify the inconsistency with Article I of trade preferences for bananas imported from ACP countries.<sup>7</sup> The European Communities (EC) subsequently obtained a temporary waiver of GATT Article I:1 for the Lomé agreement; a waiver was later granted for the successor ACP-EC Partnership (Cotonou) Agreement until December 31, 2007.<sup>8</sup>

## **WTO Waivers for U.S. Preference Programs<sup>9</sup>**

The United States holds a waiver of Article I:1 obligations for tariff preferences for the former Trust Territory of the Pacific Islands until December 31, 2016.<sup>10</sup> U.S. waivers for tariff preferences under the Caribbean Basin Economic Recovery Act (CBERA) and the Andean Trade Preference Act (ATPA), each of which pertained solely to GATT Article I:1 obligations, expired December 31, 2005, and December 4, 2001, respectively.<sup>11</sup> The United States does not hold a waiver for preferences authorized in the African

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<sup>5</sup> Agreement Establishing the World Trade Organization, Annex 1A, General Agreement on Tariffs and Trade 1994, ¶ 1(b)(iv); *see* WTO Appellate Body Report, *infra* note 16, at ¶ 90.3.

<sup>6</sup> McGovern, *supra* note 2, ¶ 9.212.

<sup>7</sup> Panel Report, *EEC — Import Regime for Bananas*, ¶¶ 156-164, DS38/R (1994), as reprinted in 34 Int'l Legal Materials 180 (1995).

<sup>8</sup> GATT, L/7604 (December 19, 1994); WTO, WT/L/436 (December 7, 2001).

<sup>9</sup> For further information on these programs, see CRS Report RL33663, *Generalized System of Preferences: Background and Renewal Debate*, by Vivian C. Jones; CRS Report RL31772, *U.S. Trade and Investment with Sub-Saharan Africa: The African Growth and Opportunity Act and Beyond*, by Danielle Langton; CRS Report RS22548, *ATPA Renewal: Background and Issues*, by M. Angeles Villarreal; CRS Report RS22541, *Generalized System of Preferences: Agricultural Imports*, by Renée Johnson.

<sup>10</sup> WTO, United States — Former Trust Territory of the Pacific Islands; Decision of 27 July 2007, WT/L/694 (Aug. 1, 2007)(covers Republic of the Marshall Islands, Federated States of Micronesia, Commonwealth of the Northern Mariana Islands, and Republic of Palau).

<sup>11</sup> World Trade Organization, WTO Analytical Index; Guide to WTO Law and Practice 87 (1<sup>st</sup> ed. 2003).

Growth and Opportunity Act (AGOA), which are available to sub-Saharan African countries through September 30, 2015.<sup>12</sup> In February 2005, the United States submitted requests for GATT waivers for the three programs through their existing expiration dates: (1) CBERA, as amended, through September 30, 2008; (2) ATPA, as amended, through December 31, 2006; and (3) AGOA, through September 30, 2015.<sup>13</sup> These programs extend duty-free treatment that in some cases is subject to quantitative restrictions and, consequently, the requests seek waivers not only of GATT Article I:1 but also of Article XIII, ¶¶ 1 and 2, which require nondiscrimination in administering quotas. The United States submitted revised requests in March 2007, reflecting recent legislative changes to these programs (see *infra* page 6).<sup>14</sup> The requests have not yet been approved, with questions on the programs raised by Brazil, China, India, Pakistan, and Paraguay.<sup>15</sup>

## **WTO-Legality of Non-Trade Conditions in Preference Programs**

In *European Communities - Conditions for the Granting of Tariff Preferences to Developing Countries*, the WTO Appellate Body (AB) explained how developed country WTO members may design preferential-tariff programs within the requirements of the Enabling Clause.<sup>16</sup> The dispute between India and the European Communities (EC) stemmed from an EC Regulation which awarded tariff preferences to a closed group of 12 beneficiary countries on the condition that they combat illicit drug production (the Drug Arrangements). India brought the claim alleging that the Drug Arrangements were inconsistent with GATT Article I:1 and unjustified by the Enabling Clause.

The initial dispute panel, in a report issued on December 1, 2003, concluded that the EC was in violation of its WTO obligations, with one panelist dissenting on procedural grounds.<sup>17</sup> Addressing the nature of the Enabling Clause and its procedural implications, a two member majority first concluded that the Enabling Clause functions as an exception to the GATT Article I:1 MFN obligation and that, consequently, the burden of proof rests

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<sup>12</sup> African Growth and Opportunity Act (AGOA), P.L. 106-200, Title I, 19 U.S.C. §§ 3701 *et seq.*, as amended by the Trade Act of 2002, P.L. 107-210, the AGOA Acceleration Act of 2004, P.L. 108-274, and the Miscellaneous Trade and Technical Corrections Act of 2004, P.L. 108-429.

<sup>13</sup> Request for a Waiver, Caribbean Basin Economic Recovery Act, G/C/W/508 (Jan. 3, 2005); Request for a Waiver, African Growth and Opportunity Act (AGOA), G/C/W/509 (Jan. 3, 2005); Request for a Waiver, Andean Trade Preferences Act, G/C/W/510 (Jan. 3, 2005) and G/C/W/510/Add.1 (Mar. 15, 2005).

<sup>14</sup> The new requests are contained in the following WTO documents, each dated March 28, 2007: G/C/W/508/Rev.1 (CBERA); G/C/W/509/Rev.1 (AGOA); and G/C/W/510/Rev.1 (ATPA).

<sup>15</sup> Paraguay has blocked the U.S. requests, having suggested compensation as a means of alleviating alleged trade damage caused by exclusion from U.S. programs; other WTO members have primarily raised textile trade issues. See the following minutes of the WTO Council for Trade in Goods: Nov. 20, 2006, at 15-21, G/C/M/86 (Jan. 3, 2007); July 12, 2006, at 3-8, G/C/M/85 (Sept. 14, 2006); May 9, 2006, at 3-11, G/C/M/84 (June 29, 2006); Mar. 10, 2006, at 3-13, G/C/M/83 (May 1, 2006); Nov. 10, 2005, at 9-12, G/C/M/82 (Nov. 28, 2005).

<sup>16</sup> Appellate Body Report, *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/AB/R (Apr. 7, 2004).

<sup>17</sup> Panel Report, *European Communities — Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/R (Dec. 1, 2003).

on the party that invokes the Enabling Clause as a defense (¶ 7.53). The lone dissenter argued that the MFN obligation does not apply to the Enabling Clause and that India did not properly bring the claim under the Clause (¶¶ 9.15, 9.21). Employing a broad reading of the term “non-discriminatory” in the Clause’s description of the GSP, the panel concluded that developed countries were required to provide “identical tariff preferences” under GSP schemes to “all developing countries” (¶ 7.161). Applying this standard, the panel then ruled that the Drug Arrangements were inconsistent with GATT Article I:1 and could not be justified under the Clause (¶ 7.177). The European Communities appealed.

The Appellate Body report, issued on April 7, 2004, first addressed the relationship between GATT Article I:1 and the Enabling Clause. The AB upheld the panel’s findings that the Enabling Clause is an exception to GATT Article I:1 and that the Clause does not exclude the applicability of Article I:1 (¶¶ 99-103). The AB explained that the Enabling Clause is to be read together with Article I:1 in the procedural sense, since a challenged measure, such as the Drug Arrangements, is “submitted successively to the test of compatibility with the two provisions.” In other words, when the Enabling Clause is implicated, the dispute panel first examines whether a measure is consistent with Article I:1, “as the general rule,” and, if it is found not to be so, the panel then examines whether the measure may be justified under the Clause (¶¶ 101-102).

Noting the “vital role” played by the Enabling Clause “in promoting trade as a means of stimulating economic growth and development” and the intent of WTO Members through the Clause to encourage the adoption of preference schemes, the AB found that the Clause was not a typical GATT exception or defense (¶ 106, 114). Thus, the AB modified the panel’s finding and held that, unlike the ordinary practice with respect to GATT exceptions, under which exceptions are invoked only by the responding party, “it was incumbent upon [complainant] India to *raise* the Enabling Clause in making its claim of inconsistency with Article I:1 of the GATT 1994” and to identify specific provisions of the Clause which it believed were violated by the respondent’s measure (¶¶ 115, 123)(emphasis in original). At the same time, the burden of justifying GSP schemes under the cited Enabling Clause provisions still rests on a respondent (¶ 125). In application, the AB found that India sufficiently raised the issue, thereby placing the burden on the EC to justify the Drug Arrangements under the Clause.

Most importantly, the AB reversed the panel’s substantive decision regarding the breadth of acceptable preference programs under the Enabling Clause. The AB found instead that developed countries can grant preferences beyond those provided in their GSP to developing countries with particular needs, but only if identical treatment is available to all similarly situated GSP beneficiaries (¶ 173). The AB elaborated that similarly situated GSP beneficiaries are all GSP beneficiaries that have the “development, financial, and trade needs” to which the treatment is intended to respond (¶ 173). In reaching this conclusion, the AB reversed the panel’s reading of the term “non-discriminatory” as used to define the GSP in the Enabling Clause. Even under the more expansive view of the Enabling Clause, however, the AB upheld the Panel’s ruling that the EC failed to prove the Drug Arrangements were in fact “non-discriminatory” (¶ 189). Two factors led the AB to its conclusion: (1) the closed list of beneficiary countries in the Drug Arrangements could not ensure that the preferences would be available to all GSP beneficiaries suffering from illicit drug production and trafficking, and (2) the Drug Arrangements did not set out objective criteria that distinguished beneficiaries under the Drug Arrangements from other GSP beneficiaries (¶¶ 187, 188).

Before the WTO Dispute Settlement Body adopted the ruling, the U.S. WTO representative stated, according to meeting minutes, that the United States was pleased that the Appellate Body had “reversed the Panel’s finding that the Enabling Clause required developed countries under their GSP programs to provide *identical* preferences to *all* developing countries” and that the AB’s decision “would help maintain the viability of GSP programs.”<sup>18</sup> The United States raised concerns, however, about the AB’s finding that complainant India needed to raise the Clause, but that the EC bore the burden of proving that the Drug Arrangements were consistent with the Clause. The United States questioned the legal basis for this “hybrid approach” suggesting that difficulties might ensue in allowing the complaining party to set the burden of proof for the respondent.

## Recent Legislation

P.L. 109-432 extends the GSP program until December 31, 2008, with an amendment calling on the President to revoke certain competitive need waivers and thus remove GSP benefits for certain products of particular beneficiary countries. The statute also extended Andean preferences until June 30, 2007, though allowing a further six-month extension for a beneficiary country that had concluded a free trade agreement with the United States, provided both parties approved the agreement by June 30, 2007. In addition, the 2006 act extends until September 30, 2012, with amendments, a provision in the African Growth and Opportunity Act (AGOA) permitting lesser-developed beneficiaries to obtain duty-free benefits for textile products regardless of the origin of the fabric or yarn used, and expands textile and apparel benefits for Haiti.<sup>19</sup>

P.L. 110-42 has extended the Andean program to February 29, 2008, and removed the trade agreement requirement enacted in 2006.<sup>20</sup> Other trade preference bills in the 110<sup>th</sup> Congress include S. 222 (Graham), which would extend to one-year the period during which the President is to determine if Haiti meets eligibility requirements for the expanded textile benefits authorized in P.L. 109-432, and S. 652 (Smith), which would authorize the expansion of trade preferences for least-developed countries. H.R. 3427 (McDermott) would limit the President’s authority to revoke any waiver of the GSP competitive need limitation by requiring that the U.S. International Trade Commission make certain determinations regarding the effect of the revocation before the President could act. No action has yet been taken on these bills.

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<sup>18</sup> Dispute Settlement Body, *Minutes of Meeting*, Apr. 20, 2004, ¶¶ 58-59, WT/DSB/M/167 (May 27, 2004)(emphasis in original).

<sup>19</sup> For further information on textile issues involving Haiti, see CRS Report RS21839, *Haitian Textile Industry: Impact of Proposed Trade Assistance*, by Bernard A. Gelb.

<sup>20</sup> Current beneficiaries of the Andean program, 19 U.S.C.A. §§ 3201 *et seq.*, are Bolivia, Colombia, Ecuador, and Peru. Free trade agreements (FTAs) have been signed with Colombia and Peru, but implementing bills have not yet been sent to Congress. Bolivia has not been engaged in FTA negotiations with the United States and negotiations with Ecuador are currently inactive. It has been U.S. policy to remove a beneficiary country from a preference program once it becomes an FTA party. *See, e.g.*, Dominican Republic - Central America-United States Free Trade Agreement Implementation Act, P.L. 109-53, § 201(a)(2),(3)(full removal from GSP; removal from CBERA, with limited exceptions).